BANKING AND FINANCE

Public consultation on Covered bonds in the European Union

Fields marked with * are mandatory.

Introduction

The Consultation Paper falls under the scope of the Capital Markets Union project and evaluates signs of weaknesses and vulnerabilities in national covered bond markets as a result of the crisis, with a view to assessing the convenience of a possible future integrated European covered bond framework that could help improve funding conditions throughout the Union and facilitate cross-border investment and issuance in Member States currently facing practical or legal challenges in the development of their covered bond markets. The Consultation Paper will trigger a debate with stakeholders on the feasibility and potential merits of greater integration between covered bond laws.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-covered-bonds@ec.europa.eu.

More information:

- on this consultation
- on the protection of personal data regime for this consultation

1. Information about you

* Are you replying as:

- ( ) a private individual
- (x) an organisation or a company
- ( ) a public authority or an international organisation

* Name of your organisation:

Association of Danish Mortgage Banks, Danish Mortgage Banks' Federation, The Danish Bankers' Association

Contact email address:

The information you provide here is for administrative purposes only and will not be published

kdb@rkr.dk

* Is your organisation included in the Transparency Register?
(If your organisation is not registered, we invite you to register here, although it is not compulsory to be registered to reply to this consultation. Why a transparency register?)

- (x) Yes
- ( ) No

* If so, please indicate your Register ID number:

27545731905-17, 457795715324-21, 20705158207-35

* Type of organisation:

- ( ) Academic institution
- ( ) Company, SME, micro-enterprise, sole trader
- ( ) Consultancy, law firm
- ( ) Consumer organisation
- (x) Industry association
- ( ) Media
- ( ) Non-governmental organisation
- ( ) Think tank
- ( ) Trade union
- ( ) Other

* Where are you based and/or where do you carry out your activity?

Denmark

* Field of activity or sector (*if applicable*):

at least 1 choice(s)

- [ ] Accounting
- [ ] Auditing
- [x] Banking
- [ ] Credit rating agencies
- [ ] Insurance
- [ ] Law
- [ ] Pension provision
- [ ] Public sector
- [ ] Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)
- [ ] Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)
- [ ] Other
- [ ] Not applicable

Important notice on the publication of responses

* Contributions received are intended for publication on the Commission's website. Do you agree to your contribution being published?
(see specific privacy statement)

- (●) Yes, I agree to my response being published under the name I indicate (*name of your organisation/company/public authority or your name if your reply as an individual*)
- ( ) No, I do not want my response to be published

2. Your opinion

PART I – Covered bond markets: economic analysis

Please refer to the corresponding section of the consultation document to read some contextual information before answering the questions.

1. In your opinion, did pricing conditions in European covered bond markets converge and diverge before and after 2007, respectively?

- (●) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

1.1 If so, what where the key drivers of this convergence/divergence?

We agree that pricing conditions in European covered bond markets converged before 2007 and have somehow returned to a more accurate risk based pricing after 2007. However, we don’t agree that the yield contraction between various European covered bonds was a sign of investors viewing those as fundamentally homogeneous assets.

Fundamentally, differences in spreads among different covered bond markets are a mirror of the credit risk of the underlying assets (in other words, the credit worthiness and wealth of the borrowers and the value of the collateral (property price)). Not only the covered bond related elements (e.g. supervision, ALM requirements, valuation requirements etc.) of the underlying legal framework, but also other elements (e.g. unemployment benefits, foreclo-sure procedures etc.) in different jurisdictions, being combined enforce the credit quality of the cover pool. Besides, the development of a covered bond market is evidently a sign of robustness of the complete covered bonds system. Although no covered bonds issuer has ever failed (and in this sense, the complete system has not been tested), markets that have lived severe economic cycles/recessions through decades have a proven ability to handle and learn from those crises, partly because throughout these decades the underlying legal framework together with the covered bond system were fine-tuned. On the other hand, those markets and frameworks established only 5-20 years ago are often inspired by and based on best practices in the already developed markets without having this fine-tuning, and indeed, those markets were never tested through a full economic cycle before 2007.

Prior to 2007, many European countries experienced an economic boom which in combination with low interest rates and access to liquidity made investors seeking for an extra yield pick-up wherever it was available. Booming housing markets made investments in covered bonds secured by mortgages seem less credit risky and, thus, differences in covered bonds frameworks, other legal frameworks, markets and economic sustainability in different jurisdictions or geographical locations became secondary in investors risk assessment.

After 2007, investors were reminded of the mistake of not taking all elements equally into account when doing a risk assessment. Thus, especially developed mortgage covered bonds markets with a more vintage portfolio of mortgages (i.e. with a long track record of low losses and a less severe economic down-turn) performed well after 2007 compared to the markets that had been growing in the booming years before 2007 and facing a deeper recession after 2007.

In this context, we believe that a truly European solution should serve equally the Eurozone and non-Eurozone covered bond jurisdictions.

Please provide evidence to support your view on the possible convergence and divergence of pricing conditions in European covered bond markets before and after 2007 respectively:

2.1 Was pricing divergence an evidence of fragmentation between covered bonds from different Member States?

- ◯ Yes
- ◉ No
- ◯ Don't know / no opinion / not relevant

2.2 Do you agree with the reasons for market fragmentation described in section 2.1 of Part I ?

- ◯ Yes
- ◉ No
- ◯ Don't know / no opinion / not relevant

2.3 Were there any other reasons?

- ◉ Yes
- ◯ No
- ◯ Don't know / no opinion / not relevant

Please explain your answers to question 2:

2.1 Was pricing divergence an evidence of fragmentation between covered bonds from different Member States?
In our opinion, the pricing divergences can to a large extent be explained by differences in investors underlying risk perceptions in the different covered bond markets. When the financial crisis hit the global economy, investors generally prefer exposures in more developed covered bond markets (systems) with a long track record of no bondholder losses. In these same Member States, this confidence is also build up over time through economic policies aimed at stabilizing the economies and, thereby, supporting job creation, economic growth and, thus, borrowers' ability to pay mortgages throughout economic cycles – even in the case where financial and economic shocks result in declining property prices, as in the Danish case. Furthermore, Member States with more solid public sector balances ("AAA" states) but not directly part of the sovereign crisis, were, in general, in a relatively better position regarding

cutting government spending and letting automatic stabilizers in their welfare systems work to stimulate the economy – compared to Member States that were directly part of the sovereign crisis.

2.2 Do you agree with the reasons for market fragmentation described in section 2.1 of Part I PDF?
In our view, the description emphasizes excessively the hypothesis that price divergences are driven by differences in public support, as solid sovereigns will use their ability to rescue troubled covered bond issuers. During the crisis, we observed that covered bond issuers had widening spreads between unsecured debt and covered bonds, which does not support the hypothesis. Furthermore, in some Southern European Member States, covered bonds actually performed better than sovereigns indicating that investors were more confident in payments from covered bond cover pools than from tax collecting central governments. This shows that the credit quality of covered bond cover pools is not directly linked to sovereign risk and that cover pools provide standalone security to bond holders – even in the most crisis hit countries.

Background note: As demonstrated by the graph (I/2b in attachment) below, covered bonds issued by different mortgage banks have zero spread, whereas senior unsecured debt issued by the same banks can have a significant spread. This illustrates that a well-functioning and robust cov-ered bond regime can contribute to delink covered bonds as funding instruments from sov-ereign risk.

2.3 Were there any other reasons?
In our opinion, the good performance of covered bonds in Member States with low sovereign risk can also be explained by investors' perception, that macroeconomic performance will be better in these Member States as their ability to absorb shocks and support the real economy is better due to solid public finances. Going the other way around, solid public finances is typically a sign of a more sound and balanced economy with better macroeconomic performance. Thus, investor confidence is higher in these covered bond markets, not just because of the proven record of low risk of the more developed covered bond systems, but also because the credit quality in these countries is supported by a better macroeconomic performance that also benefits borrowers. Please refer to question 2.b.

Another reason may be differences in market liquidity. Downward pressures on bond prices due to increasing supply will, in general, be lower in more liquid covered bond markets than in less liquid ones.

3. In your view, is there any evidence of pricing differentiation/fragmentation between covered bond issuers on the basis of size and systemic importance, as well as their geographical location?

- ○ Yes
- ◉ No
- ○ Don't know / no opinion / not relevant

Please explain your answers to question 3:

We do not find sufficient evidence of general pricing differentiation/fragmentation between covered bonds issuers on the basis of size and systemic importance. Large and systemically important covered bond markets funding mortgage lending, for example in Spain, France, Germany and Denmark, performed differently during the crisis. Pricing differentiation/fragmentation is more explained by the historical performance of the markets in differ-ent jurisdictions in combination with the depth of the economic down-turn (e.g. the relative increase of unemployment rates and capacity of sovereign support of the economy).

Thus, one could argue that the crisis showed evidence of fragmentation between covered bonds issuers on the basis of geographical location. However, this cannot be characterized as stigmatization of covered bond markets in the worst crisis-hit Member States, but is ra-ther the result of a more eroded credit quality resulting from being more emerging covered bonds markets with limited track records from previous recessions.

4. Is there an appropriate alignment in the regulatory treatment between covered bonds and other collateralised instruments?

- ○ Yes
- ○ No
- ◉ Don't know / no opinion / not relevant

Please explain your answers to question 4:

The preferential treatment of covered bonds is justified based on their performance and risk profile in the funding tool mix.

The performance of Danish covered bonds as highly liquid low-risk assets has been documented by the Danish Central Bank in its Working Papers 2012/83 on Liquidity in Government versus Covered Bond Markets: “During the crisis, trading continued in both [government and covered bond] markets but the government bond market experienced a brief but pronounced decline in market liquidity while liquidity in the covered bond market was more robust.” The exceptional performance and risk profile is further be supported by the fact that the loss rate for Danish mortgages funded by covered bonds has averaged 0.11 per-cent per annum since 1915, (see the graph below).

Loss rate on mortgages since 1915 (Graph I/4 in attachment)

At this stage, it is difficult to tell if the alignment in the regulatory treatment between covered bonds and other funding instruments are appropriate or not. We believe, however, that following a risk based approach (e.g. deciding on regulatory treatment for different funding tools based primarily on their risk profile), will guide the regulators to treat all funding instruments in an appropriate way.

The regulator is most sufficient in reaching the goals set for growth and job creation if it facilitates the market players (including the banking sector) to find (temporary) solutions for accommodating new instruments and/or creating a platform for these new instruments until a fully operating market is up and running.

Furthermore, if the regulator is choosing standardisation and only a restricted number of “SME funding templates”, it may cause market distortions and create financial instability due to the fact that risks of SME funding are not diversified.

In contrast with the aim of the CMU and in the context of the “big picture”, there is a risk that covered bonds might not get the treatment they deserve. The reason for this is that although the Commission is keen on diversification of financing resources, these financing resources are only seen in silos and are restricted to a limited number of options provided: securitisation and/or covered bond funding. The concept of a financing ladder have the potential to provide a set of funding tools for those who need it in a way that reflects a differentiated risk profile. This allows to look at the different funding instruments in a way that shows their relationship with each other as well and do not only serve an isolated primary political/economic goal.
Please refer to Addendum I/4 in attachment.

5.1 Are operational costs for covered bond issuance lower than for other collateralised instruments?

- ( ) Yes
- ( ) No
- (x) Don’t know / no opinion / not relevant

5.2 Can you quantify the respective costs, even if only approximately?

Please explain your answers to question 5:

Covered bond issuance programmes are typically expensive and cumbersome to establish. For a credit institution to establish a covered bond programme some level of economics of scale is therefore required and typically the issuer will stay committed to covered bond issuance for a long time adding stability to the instrument.

Other instruments may be characterised by a shorter time to market and lower entry costs but also less commitment to the instrument from the issuer side.

6.1 Are there significant legal or practical obstacles to cross-border investment in covered bond markets within the Union and in third countries?

- ( ) Yes
- (x) No
- ( ) Don’t know / no opinion / not relevant

Please provide evidence to support your view on possible obstacles to cross-border investment in covered bond markets within the Union and in third countries:

We are not aware of any significant obstacles to the free movement of capital within the European Union, i.e. investments in covered bonds traded on primary as well as secondary markets can flow freely within the Union.

6.2 Are there significant legal or practical obstacles to issuance of covered bonds on the back of multi-jurisdictional cover pools?

- ○ Yes
- ● No
- ○ Don’t know / no opinion / not relevant

Please provide evidence to support your view on possible obstacles to issuance of covered bonds on the back of multi-jurisdictional cover pools:

Although, for example, the definition of property is not the same all over Europe, we are not aware of significant legal or practical obstacles. Multi jurisdictional cover pools typically require the approval of the supervisor. However, in our experience, the approval process is reasonable and does not pose an obstacle.

Background note: the reason for decline in new issuance may also be the consequence of the NSFR rules treating better deposits

The difference in funding costs arises because of a provision intended to prevent excessive asset encumbrance at commercial banks, as this could lead to structural subordination in respect of other creditors. Creditors of specialised institutions which are only permitted to issue loans based on covered bonds are, in the nature of things, not at risk of structural subordination. Nonetheless, the said provision also applies to these specialised institutions, resulting in higher funding costs. Also, the series sizes requirement is a entry barrier imposed by the regulator that can prevent sound price competition from new entrants who are not able to issue the new regulatory requirement of EUR 500 million.

All in all, some new rules are deemed to have, or potentially have, an adverse impact on the availability of cheap funding in the form of covered bonds. This means that the relative competitive advantage of business models based on covered bonds funding is affected in an unfortunate way by the new requirements. This is not compatible with the aim of creating a Capital Markets Union that can foster growth and employment.

Background note: it is concluded that the issuance has been declining, but the Danish markets show the opposite.

Issuance

While the Danish market is the largest in the world in terms of outstanding covered bonds funding mortgage, it is also by far the largest market in terms of issuance. Compared to all markets covered by ECBC, about 30% of issuance of covered bonds funding mortgages in the period 2005-2014 has come from Danish issuers. Danish issuance of covered bonds funding mortgages has been stable in the period 2005-2014. For the majority of the period, yearly issuance has been in the EUR 100-200 billion range.

Graph I/6b (in attachment) Covered Bond Issuance - backed by mortgage, EUR million, 2005-2014

PART II – Exploring the case for a more integrated framework

Please refer to the corresponding section of the consultation document to read some contextual information before answering the questions.

1.1 Would a more integrated "EU covered bond framework" based on sound principles and best market practices be able to deliver the benefits suggested in section 2 of Part II?

- Yes
- No
- Don't know / no opinion / not relevant

1.2 Are there any advantages or disadvantages to this initiative other than those described in section 2 of Part II?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answers to question 1:

2.1 In your view, are market-led initiatives such as the "Covered Bond Label" sufficient to better integrate covered bond markets?

- Yes
- No
- Don't know / no opinion / not relevant

2.2 Should they be complemented with legislative measures at Union or Member State level?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answers to question 2:

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2.1 In your view, are market-led initiatives such as the "Covered Bond
Label" sufficient to better integrate covered bond markets?
We highly appreciate the creation of the Label. We consider it as an
important development, and Danish issuers subscribe to it. We consider
it a step in the process of integrating European covered bonds markets.

2.2 Should they be complemented with legislative measures at Union or
Member State level?
The combination of regulatory minimum standards and a market driven
initiative susceptible to the development in market demand is highly
valuable.
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3. Should the Commission pursue a policy of further legal/regulatory convergence in relation to covered bonds as a means to enhance standards and promote market integration?

- Yes
- No
- Don't know / no opinion / not relevant

4. Specifically, if the Commission were to issue a recommendation to Member States as suggested in section 3 of Part II would you consider that sufficient or should it be complemented by other measures (both legislative and non-legislative)? (see question 8 below)

- Yes, I consider that sufficient
- No, I think it should be complemented by other measures (both legislative and non-legislative)
- Don't know / no opinion / not relevant

Please explain your answer to question 4:

5.1 Is the suggested list of high level elements for an EU covered bond framework sufficiently comprehensive?

- Yes, it is sufficiently comprehensive
- (selected) No, it should include other items
- Don't know / no opinion / not relevant

5.1.1 Please explain which other items should be included in the list of high level elements for an EU covered bond framework:

The Commission identified a number of high level elements (below). We would like to draw the attention of the Commission to additional points which – we believe – are necessary to be looked at (at all or more in detail, marked with * r and in red in the attachment) before moving forward. These are the points that describe a (if calibrated in the right way, hopefully a well-working) national covered bond framework. However, we highlight that it has to be decided on a point-by-point basis what is necessary and feasible with regards to harmonisation at a European level.

It should be, thus, noted that when these points are examined, they should be also studied how they are incorporated in a well-functioning system. In other words, some elements may work in one system or one structure but would not work in another, if they are removed from their systemic base For instance removal of impaired loans from the cover pool would not work when you are a specialized mortgage bank. Another example is tap-issuing, that probably would not work unless you have a fitting market structure and investors/brokers who are used to it.

*Basic principles (culture, practices or non-covered bonds legislation supporting the covered bonds system):
a) registration of the mortgage – swift and credible registration;*
b) collateral – requirements for the act of perfection;
c) enforcement of liability – possibility to enforce the mortgage within a reasonable time frame if the borrower is unable to meet its payment obliga-tions;*
d) personal liability – the role of the underlying social net;*

I. Covered bond definition and protection of the term;
a) overall global definition with some privileged status (e.g. for a wide range of investors);*
b) additional criteria giving a deeper privileged status (e.g. for some more specific investors);

II. Covered bond issuers and system of public supervision:

a) issuer models and licensing requirements – including;
mapping of lending and issuance (e.g. tap issuance or potential pipeline risk);*
compliance of interest rate and currency terms of lending and funding (i.e. asset and liability imbalances);*
prepayment options (i.e. access and costs of prepayments);*
terms of credit commitment (e.g. 10, 20 or 30 years);*
terms of margins (e.g. fixed or flexible margins);*
joint funding models (e.g. pooling of cover pools from different credit institutions);*

b) on-going supervision and cover pool monitoring (pre-insolvency);
specialised supervision (i.e. supervision of covered bonds under-taken by mortgage specialists);*
c) covered bonds and the SSM;

III. Dual recourse and insolvency/resolution regime;
a) definition of dual recourse principle;
b) segregation of the cover assets;
c) pre-insolvency recovery steps;*
d) administration and supervision of the cover pool post-insolvency;
e) interaction between cover pool and issuer in insolvency/resolution;

IV. The cover pool;
a) eligible assets: qualifying criteria and requirements (risk of using equity to fund loans, dynamic cover pool and allowing small issuances*)
b) valuation principles;*
c) coverage requirement and overcollateralisation;
d) assets and liabilities risk mitigation: market and liquidity risks;

V. Transparency requirements - including;
a) reliable statistics;*
b) market information;*

5.2 should the Commission seek to develop all the elements of the suggested list of high level elements for an EU covered bond framework, or a subset of them?

- All the elements contained in the suggested list
- Only a subset of them of the elements contained in the suggested list
- Don’t know / no opinion / not relevant

Please explain your answers to question 5:

At this stage, we suggest that the Commission explores all elements and consider the possibility to supplement the list of high level elements which we listed above.

We would like to draw the attention of the Commission to additional points which - we believe - are necessary to be looked at (at all or more in detail, in red) beforemoving forward. These are the points that describe a (if calibrated in the right way, hopefully a well-working) national covered bond framework. However, we highlight that it has to be decided on a point-by-point basis what is necessary and feasible with regards to harmonisation at a Eu-ropean level.

6.1 What are your views on the merits described under section 3 of Part II of using different legal instruments to develop an EU covered bond framework? In particular, would it be desirable to harmonise through a directive some of the legal features of covered bonds and requirements applicable to them under Member States' laws?

- Yes
- No
- Don't know / no opinion / not relevant

Please describe your views on the merits described under section 3 of Part II of using different legal instruments to develop an EU covered bond framework:

6.2 If it were proposed, how could a 29th Regime on covered bonds be designed to provide an attractive alternative to existing national laws?

Please explain your answers to question 6:

7. How should an EU covered bond framework deal with legacy transactions?

In the first place, a situation where grandfathering is necessary should be avoided. If grandfathering proves to be necessary, it should be taken into account that there are grandfathering rules already in place for covered bonds. Adding a new layer grandfathering rules may have a negative impact on liquidity and investor transparency, as investors would need to assess two different classes of grandfathered covered bonds (i.e. covered bonds grandfathered either in 2008 or in 20xx).

An effort should be made to ensure that the new definition of a covered bond is not a radical break with the existing definition, necessitating the establishment of new cover pools with grandfathering schemes for earlier issues. Such a maneuver would be both cost-intensive and detrimental to bond series' liquidity.

8. Would you view a combination of recommendations to Member States (Option 1) and targeted harmonisation of certain minimum standards (Option 2) as desirable and sufficiently flexible?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answers to question 8:

PART III – Elements for an integrated covered bond framework

Please refer to the corresponding section of the consultation document to read some contextual information before answering the questions.

1. Covered bond definition

1. What are your views on the proposals set out in section 1 of Part III for a "new legal definition" of covered bonds to replace Article 52(4) of the UCITS Directive?

The Consultation Document considers to repeal the current definition of covered bonds set out in article 52(4) of the UCITS Directive with a new definition conform to a harmonised covered bond framework.

Article 52(4) of the UCITS defines covered bonds by three principles:
i. the covered bond issuer must be a credit institution which has its registered office in a member state;
ii. the covered bond issuer must be subject to special public supervision designed to protect covered bond investors;
iii. proceeds from the issuance of covered bonds must be invested in eligible assets and covered bond investors must have a preferential claim on payments on the assets in the event of issuer bankruptcy.

On top of these principles article 129 of the Capital Requirement Regulation lays down minimum requirements on cover assets and transparency. These requirements must be met for the covered bonds to qualify for preferential risk weights with investors following the standardised method for calculating credit risk:

iv. covered bonds must be collateralised by exposures on local or national authorities, central banks, financial institutions within a 10 or 15 percent limit, or loans secured by real estate within loan to value limits measured on a current value basis;
v. covered bond investors must receive information on the value of the cover pool and outstanding covered bonds, the distribution of cover assets on geography, type, loan size, interest rate, and currency, the maturity structure of cover assets and covered bonds, and the percentage of loans more than ninety days past due.

Following the above covered bonds meeting the definitions of article 52(4) of UCITS constitute a subset of covered bonds qualifying for preferential risk weights under article 129 of the Capital Requirement Regulation.

Graph III/1 (in attachment) Definitions of covered bonds

Covered bonds meeting the definitions listed in point (i) to (iii) but failing to meet the requirements listed in either point (iv) or (v) remain covered bonds under national and EU law albeit they carry a higher risk weight with investors following the standardised method for calculating credit risk.

It is imperative that the regime of a broader definition of covered bonds combined with nar-row criteria for preferential risk weight be maintained under a future harmonised EU framework for covered bonds.

In certain scenarios the requirements for preferential risk weight listed under point (iv) may prove impossible for covered bonds issuers to satisfy. In particular, in scenarios of substan-tial property market deflation it may prove impossible for covered bond issuers to observe loan to value limits on a current value basis. Similarly, in scenarios of a deep economic recession it may prove impossible for covered bonds issuers to observe the requirement to replace non-performing mortgages which is considered a future requirement in the Consultation Document. These scenarios are of particular concern to specialised credit institution which cannot respond to the scenarios by replacing non-compliant mortgages inside the cover pool with compliant mortgages outside the cover pool. In such scenarios it is impera-tive that the legal status of a covered bond remains certain.

Under current national and EU law the covered bonds would remain covered bonds not qualified for preferential treatment, however, the covered bond investor would still benefit from the bankruptcy privilege, the covered bond would remain eligible as high quality liquid assets etc.

Under a future harmonised EU framework based on a single tier covered bond definition there is an inherent risk that failure to comply with requirements to observe loan to value limits on a current value basis or failure to comply with requirements to replace non-performing mortgages in cover pools, which could be purely market driven, could lead to legal uncertainty as to the status of the covered bonds which again could lead to substantial cliff effects and be highly disruptive. This could be avoided if the regulation, in general, gave preferential treatment to highly rated UCITS-compliant covered bonds, as it is the case in LCR and Solvency II. Such bonds are typically secured by mortgages and supplied by overcollateralization to account for the actual risk in the cover pool in different stress scenarios (otherwise they would not have the high rating). A non-risk based LTV collateral requirement on top of that is not in the interest of bond holders, as it is both costly to fund the extra redundant collateral, and even more importantly, it creates the cliff effect risk of the bond losing its covered bond status and preferential treatment when property prices decrease.

2. Covered bond issuers and system of public supervision

2.1 Issuer models and licensing requirements. Role of SPVs (see document)

1.1 Should the current licensing system be simplified to require a "one-off" authorisation only for all covered bond issuers based on common high level standards?

- Yes
- No
- Don’t know / no opinion / not relevant

1.2 What specific prudential requirements (that is, in addition to those in CRR and CRD) could be applied as a condition for granting a covered bond issuer license?

Please explain your answers to question 1:

Danish issuers of covered bonds have required a general “one-off” authorization from the Danish FSA. The authorization is based on the issuer’s demonstration of its capability of handling the basic elements (e.g. registration of segregated assets, valuation of assets etc.), daily administration (e.g. adding or removing assets from cover pool, cash management to investors etc.) and risk management (e.g. ALM-systems etc.).

Issuers that want to use more complex models – for instance joint funding models between several covered bonds authorized institutions – have to require an additional specific authorization from the Danish FSA. This authorization is based on the issuer’s additional demonstration of its capability of handling such complex model – e.g. securing the issuing institutions access to the assets in cover pools in the other institutions and cash management of payments from the institutions granting the mortgage lending to the institutions issuing covered bonds.

2.1 If the covered bond issuer is subject to a one-off covered bond-specific licence, what would be the additional benefits of requiring that each covered bond programme be subject to prior authorisation as well?

We see no additional benefits of requiring authorization of each covered bond programme from issuers subject to a one-off covered bond-specific license.

2.2 Alternatively, would pre or post notification to the competent authority of the programme and of each issue within or amendment to the programme suffice?

- Yes
- No
- Don’t know / no opinion / not relevant

2.3 How should "covered bond programme" be defined for these purposes?

Please explain your answers to question 2:

3.1 Should the Framework explicitly allow the use of SPVs to ring-fence cover pools of assets backing issues of covered bonds?

- Yes
- No
- Don’t know / no opinion / not relevant

3.2 What specific requirements should apply to these SPVs?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answers to question 3:

4.1 Would it be desirable for an EU covered Bond Framework to allow the use of pooled covered bonds structures and SPVs?

- (selected) Yes
- No
- Don’t know / no opinion / not relevant

4.2 Please explain why you think it would be or wouldn't be desirable:

Allowing the use of pooled covered bonds structures and SPVs gives the smaller European banks the opportunity to combined access to large and liquid funding markets. This means that clients in smaller banks - typically retail customers and SMEs - get cheaper funding and at the same time keep the business relationship with the local bank.

4.3 What legal structures are used in your jurisdiction to pool assets from different lenders or issuers?

Danish mortgage banks are specialised credit institutions. Their business model is based on not receiving deposits but instead raising funding from the public in the form of issuing covered bonds. They are, thus, credit institutions under the CRR. The mortgage banks, therefore, originate the mortgage loan itself in the same group and issue the corresponding amount of covered bonds that finance the loans granted by the mortgage bank. Loans may also be transferred to a Danish mortgage bank according to a structure in which the mortgage bank has knowledge of and in responsible for correct valuation of the mortgaged property and verification of the debtor's creditworthiness and ability to pay.

Danish specialized mortgage banks can also fund mortgage lending granted by other mortgage banks, conditional upon special "joint funding" approval by the Danish FSA. In order to obtain such approval, both mortgage banks must be licensed mortgage banks including licensed covered bonds issuers. The terms and conditions on payments between the two mortgage banks must be set in the so-called master covered bond making sure that payment from the borrowers in the non-issuing mortgage bank covering the funding costs of the mortgage lending is timely transferred to the real covered bonds issuing mortgage bank to cover payments to the bond holders.

Danish mortgage banks can - as well - purchase loans granted by other banks and finance those by issuing covered bonds, conditional upon special approval by the Danish FSA. In order to obtain such approval the process has to ensure that the loan transfer meets the same requirements as if the mortgage had been originated by the mortgage bank itself. However at the same time the originating bank retains the client management and loan administration.

4.4 Which approach would be the most suitable for pooling assets across borders?

We believe that both approaches, i.e. several decentralized cover pools with a tight legal pass through setup to one covered bonds issuer or a tight legal smooth setup of transferring assets to one centralized cover pool, can be suitable. It depends on the market structure (e.g. number of large and small players) as well as other legal issues (e.g. taxation rules or debtor protection rules).

4.5 Where the issuer of pooled covered bonds is an SPV, should this issuer be regulated as:

- a credit institution
- some other form of legal entity
- Don't know / no opinion / not relevant

Please explain your answers to question 4:

2.2 On-going supervision and cover pool monitoring (pre-insolvency) (see document)

1.1 In your view, would it be desirable for an EU covered bond Framework to set common duties and powers on competent authorities for the supervision of covered bond programmes and issuers?

- Yes
- No
- Don't know / no opinion / not relevant

1.2 What specific duties and powers should be included in the Framework and/or EBA or ESMA Guidelines?

Please explain your answers to question 1:

Supervisory authorities are better placed to answer this question.

2. What are your views on the proposals set out in subsection 2.2 of Part III on the appointment of and legal regime for cover pool monitors?

We share the EBA recommendation (on page 80 of EBA Report on EU Covered Bond Frameworks and Capital Treatment, December 2012) that the appointment of a cover pool monitor is not necessary if the similar tasks of such monitor are carried out by the competent authority. This is the situation for specialised mortgage banks in Denmark. Besides there is no sufficient evidence to prove that any advantages could be achieved by delegating these tasks to a third party. Such measure would merely increase the cost of lend-ing/borrowing.

Please explain your answer to question 2:

The cover pool monitor in Denmark

The Danish Financial Supervisory Authority (FSA) performs regular on site inspections in which they extract loan offers to be screened with regard to the property valuation/appraisal. Should the FSA find that the valua-tion of the property is set too high, the mortgage bank will be ordered to reduce the loan funded by covered bonds and replace it with a loan financed by the equity. The mortgage banks are required to make regular reporting of their issued loan offers (and thereby the property valuation) to the FSA. The mortgage banks also perform a regular LTV monitoring according to specific models/business routines that are approved and regularly reviewed by the FSA. Furthermore there is a very intensive regulation of property categories, valuation and monitoring. Pursuant to Danish FSA executive order on series financial statements in mortgage banks the Danish mortgage banks are required to prepare separate financial statements for each cover pool. The Danish mortgage banks are classified as SIFI and are therefore (and as a consequence) subject to a very close supervision.

2.3 Covered bonds and the SSM (see document)

1. Should the ECB have specific supervisory powers?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Please explain your answers to question 1:

3. Dual recourse and insolvency/resolution regime

3.1 Definition of dual recourse principle (see document)

1. Do you agree with the proposed formulation for "dual recourse"?

- ○ Yes
- ● No
- ○ Don't know / no opinion / not relevant

Please explain your answer to question 1:

The definition does not take into account that derivative counterparties (hedging imbalances between the covered bonds and the loans), which, typically have the same legal position as the covered bond holders. Furthermore, in Denmark the bondholders still have a privileged claim (and not only a senior unsecured claim) against the insolvency estate in case the cover pool ("Capital Centre") does not suffice. The definition should be amended accordingly.

Dual recourse is implemented in Danish legislation. Covered bond investors have a priority claim over the cover assets in a capital centre. Under Danish legislation, issuers may have more than one cover pool. Any residual claims of holders of issued covered bonds from a specialised mortgage bank rank before the claims of unsecured creditors. It is also mentioned in a footnote in the recommendation in the EBA report (on page 110 and 143 of EBA Report on EU Covered Bond Frameworks and Capital Treatment, December 2012) saying "In the case of non-deposit-taking specialised covered bonds issuers, i.e. issuers whose business only or predominantly focuses on the issuance of covered bonds, the covered bond investor could instead also be granted a claim on the covered bond issuer's insolvency estate which ranks senior to the claim of the issuer's unsecured creditors."]

3.2 Segregation of the cover assets (see document)

1.1 Are there any advantages to using an SPV as an additional segregation mechanism at issuance?

- Yes
- No
- Don't know / no opinion / not relevant

1.2 Are cover assets typically transferred to the SPV at issuance via legal or equitable assignment?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answers to question 1:

2.1 In your jurisdiction, what legal and practical steps are required in order to segregate effectively the cover assets from the issuer's insolvent estate or in resolution?

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All assets are assigned to specific cover pools, in Danish regulation
referred to as Capital Centers. Each Capital Centre must comply with
minimum capital requirements implied by the CRR. Assets may be
transferred from one Capital Centre to the other insofar as the Capital
Centre is solvent. If the transfer would lead to insolvency transfer is
prohibited by law. Further, if insolvency procedures have been initiated
transfer of assets between Capital Centers is prohibited in general.
```

2.2 Would it be necessary to serve a notification to each borrower of the issuer?

- ( ) Yes
- (•) No
- ( ) Don't know / no opinion / not relevant

2.3 Until notification is served, what is the legal status of any proceeds of the cover assets which may be paid directly into the insolvent estate or to the issuer in resolution?

```
Since there is no commingling risk, the proceeds will be distributed to
each cover pool (Capital Centre). It should be noted that every Danish
mortgage bank has several cover pools (Capital Centres) due to the long
term issuance of covered bonds and product developments.
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Please explain your answers to question 2:

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2.2 Would it be necessary to serve a notification to each borrower of
the issuer?
No, there's no commingling risk due to the narrow business area for the
Danish mortgage banks (non-deposit taking and only funding loans with
covered bonds). However, the reso-lution authority or the liquidator in
insolvency would, most likely, inform the borrowers to continue the
payments.
2.3 Until notification is served, what is the legal status of any
proceeds of the cover assets which may be paid directly into the
insolvent estate or to the issuer in resolution?
Since there is no commingling risk, the proceeds will be distributed to
each cover pool (Capital Centre). It should be noted that every Danish
mortgage bank has several cover pools (Capital Centres) due to the long
term issuance of covered bonds and product developments.
```

3.3 Administration of the cover pool post insolvency/resolution of the issuer (see document)

3.3.1 Legal form and supervision of the cover pool

1. Should the cover pool be incorporated as a regulated entity?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answers to question 1:

The particular rules in the BRRD and the tools contained therein will probably have been sought to be used by a mortgage bank before it comes under insolvency procedures. The replies below relate to insolvency/bankruptcy procedures.

It should follow from a regulatory initiative what happens in case of insolvency/bankruptcy – or minimum requirements for such procedures to be compatible with a mortgage framework should be defined. It should be ensured that the preferential treatment of bondholders (investors) is clearly protected. In case of insolvency/bankruptcy, the cover pools of a mortgage bank are segregated from each other in order to ensure that the assets stay at the preferential disposal of the investors under the rules of the insolvency/bankruptcy. Furthermore, there is no acceleration of debt in case of insolvency/bankruptcy.

2. Who should be the supervisory authority for these purposes, the competent authority or the resolution authority?

Ensuring the investors’ interests, including servicing the mortgage bank cover pools, are the key task in case of insolvency/bankruptcy. This task has to be handled by the liquidator. A liquidator should be appointed by a court after consultation with the supervisor. It is vital that a liquidator has the sufficient special knowledge and qualifications, and trust from the supervisor. Appointment should, thus, be conditional upon the supervisor agreeing on the qualifications of the liquidator.

3.3.2 Special administrator of the cover pool

1. What are your views on the proposals set out in subsection 3.3 of Part III on the appointment and legal regime for a cover pool special administrator?

The mentioned items are all vital in ensuring the investors’ interests and the creditors’ interests.

2.1 Should the special administrator be obliged to report regularly to the relevant supervisory authority?

- (•) Yes
- ( ) No
- ( ) Don’t know / no opinion / not relevant

2.2 Should the content and regulatory of such reporting be the same as for the issuer?

- ( ) Yes
- ( ) No
- ( ) Don’t know / no opinion / not relevant

Please explain your answers to question 2:

> 2.1 Should the special administrator be obliged to report regularly to the relevant supervisory authority?
> Yes. The liquidator should report to the court. It should be ensured that the supervisor has access to this reporting and that the supervisor may participate in all meetings of the court, including committees or other activities connected to the handling of a procedure.
>
> 2.2 Should the content and regulatory of such reporting be the same as for the issuer?
> The resolution of a Danish mortgage bank is based on a structured process that will last for the period equal to the duration of the mortgages in the cover pool. The purpose is to maintain the cover pools as going concern so as to ensure it meets its obligations towards the creditors independently from the troubles of the mortgage bank as such. This implies that most obligations of a going concern credit institution should be maintained for the cover pools under liquidation, taking into account the particular circumstances.

3.3.3 Ranking of cover pool liabilities

1.1 Do you agree with the suggested ranking for cover pool liabilities?

- (•) Yes
- ( ) No
- ( ) Don’t know / no opinion / not relevant

1.2 Is the wording proposed in subsection 3.3 of Part III sufficient to define clearly the claims that may arise, avoid confusion between claims and prevent claims in an unreasonable amount from arising?

- (selected) Yes
- No
- Don't know / no opinion / not relevant

Please explain your answers to question 1:

> 1.2 It should be the liquidator, and ultimately the court, that has the competence to decide if the costs associated with the liquidation process are reasonable. The liquidator should be in close contact with the court to assess what is necessary to ensure a sufficient and responsible treatment of the mortgage bank estate. The overall purpose should be to ensure protection of the creditors, not least the bondholders (investors).

2. Is it possible to define hedging activity better?

- Yes
- No
- Don't know / no opinion / not relevant

2.1 How is it possible to define hedging activity better?

> An eligible hedging activity should be defined as financial instruments hedging imbalances between the mortgage loans and the covered bonds.

3.4 Interaction between cover pool and issuer in insolvency/resolution (see document)

1.1 Are current provisions in EU law sufficient to deliver effective protection for boldholders in a resolution scenario involving covered bonds?

- Yes
- No
- Don't know / no opinion / not relevant

1.2 In particular, is it sufficiently clear:

	Yes	No	Don't know No opinion Not relevant
how the cover pool would be segregated under each possible resolution or recovery scenario of the issuer?			
how the full recourse against the issuer would take effect if the issuer is in resolution and is not placed subsequently into liquidation?			
what procedural steps should be followed in resolution and by whom in order to make effective the dual recourse mechanism?			

Please explain your answers to question 1:

1.1 Are current provisions in EU law sufficient to deliver effective protection for bondholders in a resolution scenario involving covered bonds?
With the implementation of BRRD, we now have provisions in EU law, which can provide protection for bondholders in a resolution scenario.

It has to be stated that there are different covered bond models in Europe, where the impact of the BRRD implementation can differ from one EU member state to another.

We still see some potential threats to the protection of bondholders in BRRD - for example in relation to valuation of the assets in case of resolution and in relation to protection OC in cover pools. In other words, if insufficient OC remains in the cover pool in case of restructuring, it will have negative implications on available funding and thus for the cost of funding for borrowers impeding growth.

1.2 In particular, is it sufficiently clear:
how the cover pool would be segregated under each possible resolution or recovery scenario of the issuer?
It is not clear in the EU law, how the cover pool would be segregated, which has to be regulated in national legislation.

how the full recourse against the issuer would take effect if the issuer is in resolution and is not placed subsequently into liquidation?
This question is also not quite clear in EU-law, especially, if the bridge institution tool is applied and the liabilities are greater than the assets in the cover pool.

what procedural steps should be followed in resolution and by whom in order to make effective the dual recourse mechanism?
The answer to this question is depending on the resolution actions taken by the resolution authorities and the kind of covered bond model which is applied in the Member State.

2.1 Should the Framework provide for a cut-off mechanism as suggested in subsection 3.4 of Part III?

- ( ) Yes
- (x) No
- ( ) Don’t know / no opinion / not relevant

2.2 In particular, should such a cut-off mechanism:

	Yes	No	Don’t know No opinion Not relevant
preclude the closure of insolvency or resolution before possible residual claims from the covered bondholders against the issuer or the insolvent estate have been identified and quantified?	○	○	●
set out clear and objective requirements on the valuation of the cover pool and the timing for such valuation?	○	○	●
extinguish the residual claim on the estate or the successor credit institutions after sufficient assets have been segregated for the benefit of covered bondholders at the outset of the resolution or insolvency proceedings?	○	○	●
give specific powers and duties to the resolution authority and, if so, what should those consist in?	○	○	●

Please explain your answers to question 2:

2.1 Should the Framework provide for a cut-off mechanism as suggested in subsection 3.4 of Part III PDF?
No. In our opinion, a potential framework should not provide for a cut-off mechanism as suggested in the Consultation paper. We favour a long process where there is no acceleration on neither the covered bonds or on the underlying assets. In our view, a cut-off mechanism could lead to fire-sale issues which will not be for the benefit of bondholders or the underlying assets of a cover pool.

2.b
We do not favour a cut-off mechanism.

Applying the cut-off mechanism in case of insolvency of the issuer, the credit rating of the cover pool would be weakened. Calculating the residual claim, in case of applying the cut-off mechanism would lead to an increased LGD, therefore a lower rating.

Applying the cut-off mechanism would prevent the cover pool to issue covered bonds or, at least, increase the OC requirement from the rating agencies.

Especially on the subject of specialized mortgage banks, it is a reinforcement of the entire covered bonds system that a surplus/profit in the cover pool B can be of benefit to investors in cover pool A, if the funds in cover pool A turn out to be insufficient.

Please note that Danish mortgage banks issue covered bonds with a 30-year maturity.

The cut off mechanism accommodates the interest of creditors of a universal bank issuing covered bonds. It is, therefore, essential to make a distinction between the universal and specialized mortgage banking model. The latter - due to being a non-deposit taking institution - does not face the same need to repay over a shorter period in case of insolvency. Investors and rating agencies may regard an introduction of a cut-off mechanism for specialized mortgage banks as a clear road to issue problems (which would be reflected in the rating) or they can increase OC requirements as a result.

The effect of the cut-off mechanism is very similar to a SPV construction, since it is only the cover pool including the added funds to which the investors can relate. This is precisely the difference between covered bond issuers and an SPV issuing MBSs. Covered bonds issuing has a structure that comprises far more protection mechanisms (e.g. capital requirements, LCR requirements, dual recourse etc.)

4. The cover pool

4.1 Eligible assets: qualifying criteria and requirements (see document)

4.1.1 Residential and commercial loans

1.1 Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets?

- (x) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

1.2 Should certain riskier residential or commercial loans (ie buy-to-let mortgages; second home loans; loans to real estate developers; etc.) be excluded from the cover pool or permitted subject to stricter criteria?

- ( ) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

Please explain your answers to question 1:

> 1.1 Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets?
> Yes, but it should be supplemented by fixed LTV limits which are differentiated based on the property category.
>
> 1.b Should certain riskier residential or commercial loans (i.e. buy-to-let mortgages; second home loans; loans to real estate developers; etc.) be excluded from the cover pool or permitted subject to stricter criteria?
> There's no need for such restrictions. Any potential risks will be mitigated by the capital requirements (that applies on cover pool level in Danish specialized mortgage banks) or other assets in the cover pool. Furthermore, there must be strict rules on valuation, LTV limits and certain transparency requirements for the disclosure of the assets behind the loans in the cover pool.

2.1 In relation to mortgage loans, what are your views on the proposed requirements on "perfection of security" and "first ranking mortgage"?

- ( ) Yes
- (x) No
- ( ) Don't know / no opinion / not relevant

2.2 Is registration of the security a requirement for perfection in your jurisdiction?

- (x) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

2.3 Is the enforceability of mortgages in the different Member States equivalent or should there be additional requirements to ensure their equivalence?

- ( ) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

2.4 Are minimum standards for mortgage rights in third countries necessary?

- ( ) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

Please explain your answers to question 2:

2.1 In relation to mortgage loans, what are your views on the proposed requirements on "perfection of security" and "first ranking mortgage"? We do not agree with the concept of "perfection of security". Perfection of security has to be seen together with the national rules. The basic requirement must be to register a mortgage correctly on a timely basis, and to fulfil all legal requirements for establishing a mortgage . (refer to Article 208(2) of the CRR).

A mortgage should become eligible as collateral prior to the completion of the registration process. In the interim a registration guarantee provided by an eligible counterpart should serve as collateral.

"First ranking mortgages" should not become a requirement. The important requirement is the LTV-level and not the ranking. Loans within a defined LTV-limit should be allowed as assets in the cover pool. The purpose of the loan and the ranking of the loan are less important as long as there are sufficient assets in the cover pool, inter alia based on LTV limits.

Furthermore, the mortgage should be legally enforceable independently of ranking, i.e. each bank holding a lien on a property can initiate the sale of the property independently from other entities holding a lien on the property.

2.2 Is registration of the security a requirement for perfection in your jurisdiction?

Yes.
A mortgage should become eligible as collateral prior to the completion of the registration process. In the interim a registration guarantee provided by an eligible counterpart should serve as collateral.

A land registration system governed by public law is essential in ensuring that mortgages may serve as cover assets for loans.

In Denmark, to serve as cover assets, mortgages must be entered in the Danish land register, which is kept by the Danish district courts. The responsibility for any errors in the registration system lies with the authorities on an objective basis. The Danish land register is digital and registration of mortgages may be effected within few minutes.

2.3 Is the enforceability of mortgages in the different Member States equivalent or should there be additional requirements to ensure their equivalence?
It must be possible to enforce the mortgage within a reasonable time frame if the borrower is unable to meet its payment obligations. Enforcement must be possible without the institution incurring any significant financial or other obligations as a condition for or a result of such enforcement.

If a borrower in Denmark defaults on a loan, legal action will soon be taken, ending with a forced sale. The period from default to a forced sale is about 6 to 9 months and personal liability remains if the claim is not covered by the forced sale. The costs of forced sales are relatively low. The Danish state also secures rehousing of borrowers in need.

3.1 In relation to LTVs, what are your views on the proposals set out in subsection 4.1 of Part III on minimum LTVs?

Current loan to value limits at 80 percent for residential mortgages and 60 percent or 70 percent for commercial properties are reasonable and reflect the underlying risk. Current loan to value limits should be maintained.

As a basis, LTV limits should be observed at the inception of the mortgage in the cover pool. For specialised credit institutions this would correspond to the time of origination.

3.2 In the case of insured properties, should higher LTV limits be allowed if the insurance cover meets certain requirements?

- Yes
- ● No
- Don't know / no opinion / not relevant

Please explain your answer to question 3.2:

3.3 In what other cases should higher LTV limits be allowed?

No comments

3.4 Could loan-to-income requirements be used to replace or complement LTV limits?

We do not support loan-to-income requirements in legislation. Both loan-to-value (LTV) and loan-to-income (LTI) are important elements of assessing the credit quality of the assets in the cover pool. However, while LTV limits have a significant bearing on the quality of the underlying collateral (the property), LTI considerations are only parts of the credit assessment of the borrower.

The credit assessment process is very complex and lenders should consider all relevant information. A simple LTI-requirement may say little or nothing about creditworthiness. Other elements like access to other liquid assets, pension savings, disposable household income after fixed costs (utility, insurance etc.), expected future income, risk of unemployment etc. are equal parts of the credit assessment. As such LTI should remain with the prudential supervision of the issuer as follows from already existing regulations.

3.5 Should there be an additional average LTV eligibility limit at portfolio level?

- [ ] Yes
- [x] No
- [ ] Don’t know / no opinion / not relevant

Please explain your answer to question 3.5:

Eligibility should be determined on the basis of the loan to value ratio of the individual mortgage only. In pursuance of article 129(1) of the CRR mortgages are eligible as cover assets for the part of the mortgage not exceeding the loan to value limit on a current value basis. This requirement has introduced pro cyclicality as a part of the mortgage will become ineligible as property prices decline. This is of particular concern to specialized credit institutions for which all mortgages are assigned to cover pools as the issuer is not in a position to replace high loan to value mortgages inside the cover pool with low loan to value mort-gages outside the cover pool, see our memo on covered bond issuer models.

An additional average loan to value eligibility limit at portfolio level may escalate pro-cyclicality in particular if the limit is set at lower levels than applies to each mortgage.

As argued in our memo the risk from higher loan to value mortgages within the cover pool is fully covered bond by higher capital needs.

3.6 With the advent of a Binding Technical Standard defining Mortgage Lending Value, is it appropriate to apply this for eligibility in all cover pools across the Union as a prudent measurement?

- ( ) Yes
- (x) No
- ( ) Don't know / no opinion / not relevant

Please explain your answer to question 3.6:

In our opinion Article 208 of the CRR provides sufficient requirements for valuation. On this basis, mortgage banks can apply either market value or a mortgage lending value.

3.7 Should LTV limits:

at most 4 choice(s)

- [x] be used to determine: eligibility (loan in/out) of loans at inception?
- [ ] be used to determine: eligibility (loan in/out) of loans on an ongoing basis?
- [ ] be used to simply determine contribution to coverage?
- [ ] Don't know / no opinion / not relevant

Please explain your answer to question 3.7:

LTV limits should be applied for the determination of eligibility of a mortgage at inception only. Whilst a universal credit institution may be able to replace a loan LTV breaches inside the cover pool with an eligible loan within LTV limits outside the cover pool, a specialized credit institution instead covers the risk from increasing LTV ratios by observing higher capital requirements. Please note that for specialised credit institutions in France and Denmark all assets and liabilities - including capital and liquidity funded by the capital - form part of the cover pool. Any rule that disqualifies eligible loans because of high LTV - in part or in full - is therefore more onerous in the context of a specialised institution.

The Consultation Document considers whether LTV requirements should be applied for the entire duration of the covered bond issued and whether LTV ratios should be updated frequently. To some extent these questions are addressed by Article 208 of the CRR.

A universal credit institution would be in a position to replace high LTV mortgages inside the cover pool with low LTV mortgages outside the cover pool in response to requirements such as those considered by the Consultation Document.

A specialised credit institution, on the other hand, would not be in a position to replace high LTV mortgages with low LTV mortgages outside the cover pool as no such mortgages exists. The specialised credit institution would cover the economic risk from holding high LTV mortgages by capital, insofar as the high LTV ratios imply higher expected loss raising the capital need. If high LTV mortgages were not to be counted as collateral, the specialised credit institution would need to issue debt ranking junior to covered bonds or equity for the funding of eligible securities to restore over-collateralisation levels. In other words, the risk is covered twice by (i) an increase in capital need and (ii) eligible securities funded by debt ranking junior to covered bonds or equity which is disproportionate.

4.1 In relation to the valuation of cover assets, how frequently should the value be updated and in which way (revaluation, update of the initial valuation, and in which way)?

The requirements under Article 208 of the CRR are appropriate, in our view.

4.2 what criteria should be applied to (i) the valuer and (ii) the valuation process to ensure that they meet the transparency and independence principles set out in the first and second subparagraphs of Article 229(1) CRR?

The valuer of a property has to possess the necessary and sufficient qualifications to be able to do the valuation. The qualifications may be acquired theoretically as well as in practice. The valuer should be able to document theoretic knowledge and also to certify practical knowledge via CV and statements from relevant companies in the industry.

The issuer has to specify requirements to the valuer based on their knowledge of the market, market standards and the specific valuer. This has to be done on a continuous basis and the issuer is responsible for the necessary educations and knowledge update of the valuers. Valuers are not part of the credit process, and their management should be independent from the credit granting process as well. The valuation process is specified and documented by the issuing institution based on organisation and business model. A specific valuation should be documented with information on the actual property as well as the statistical basis for the valuation.

5. Should the Framework adopt the definition of "non-peforming exposures" as set out in the EBA's draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-performing Exposures?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answer to question 5:

In our jurisdiction a loan is non-performing, if the payment is late by more than 90 days.

It should be noted, however, that a range of credit actions are triggered and processed before loans become non-performing.

The Consultation Document further considers a proposal to exclude non-performing mortgages from the cover pool. On this proposal it is necessary to fully understand the difference between universal credit institutions and specialised credit institutions.

The balance sheet of a universal credit institution reflects the diversification of business activities. Assets may include unsecured loans, loans se-cured by mortgages, loans otherwise secured and securities holdings whereas liabilities may include deposits, unsecured debt, covered bonds, other secured debt, and equity.

Cover pool assets may include only a subset of assets eligible as collateral for covered bond issuance. The issuer is therefore able to replace assets in the cover pool with assets from outside the cover pool or to add additional assets as over collateralisation in support of the covered bond issued marked by the arrow (a) in the below chart. However, this may give rise to asset encumbrance concerns.

The balance sheet of a specialised credit institution is less diversified but more transparent. Assets of a specialised credit institution include loans secured by a mortgage and securities holdings whereas liabilities include covered bonds, other debt, and equity only. Stylised versions of these balance sheet structures are shown in the chart (Graph III/4.1/5 in attachment).

Balance sheet structure of universal and specialised credit institution, stylised

In some jurisdictions, e.g. France and Denmark, the bankruptcy privilege of covered bond investors includes all assets on the balance sheet of specialised credit institutions. Consequently, securities holdings, whether funded by debt ranking junior to covered bonds issued or equity form part of the cover pool and are recognised as over collateralisation in support of the covered bonds issued.

As credit institutions, specialised institutions must comply with the capital and liquidity coverage requirements of the Capital Requirement Regulation. With the balance sheet structure of a specialised bank, this means that any increase in risk on cover assets entails an increase in over collateralisation in support of the covered bond issued. Capital and liquidity coverage requirements work as a ‘transmission mechanism’

A universal credit institution with the balance sheet structure shown in the chart would be able replace non-performing mortgages inside the cover pool with performing mortgages from outside the cover pool. This does not imply extra costs, but it increases asset encumbrance as non-performing assets are replaced by performing assets from outside the cover pool.

A specialised credit institution with the balance sheet structure shown in the chart would not be able to replace non-performing mortgages with performing mortgages from outside the cover pool, since no such mort-gages exists.

The specialised credit institution covers the economic risk from the non-performing mortgages by its loan impairment charges which reduce its capital marked by the arrow (b) and, consequently, the amount of securities serving as over collateralisation. Consequently, the economic risk from non-performing mortgages is fully covered within the scope of the specialised credit institution covered bond issuer model.

To restore over-collateralisation, the specialised credit institution would need to restore its capital or issue other debt for the funding of over collateralisation. If non-performing mortgages were to be excluded completely from the cover pool the specialised mortgage credit institution would need to restore the outstanding balance of the mortgage either by capital or by debt which would be disproportionate.

6.1 In light of the EBA's prudential concerns in relation to the use of RMBSs and/or CMBSs in cover pools:

- should the Framework exclude these assets completely from qualifying as cover assets (including, for these purposes, as substitution assets)
- or should they be allowed only subject to strict criteria and within the 10% limit currently permitted under Article 129 of the CRR?
- Don't know / no opinion / not relevant

6.2 What is the added value and practical uses of RMBS/CMBS as collateral in your jurisdiction/issuer?

In Denmark, the use of RMBSs and/or CMBSs in cover pools under CRD III was not allowed without a specific license from the Danish FSA. Under this framework a license was granted to one Danish covered bonds issuer, the Nykredit Group, which among several entities is comprised by two specialized mortgage banks: Nykredit Realkredit and Totalkredit.

The Nykredit Group got a license in 2005 allowing all mortgage lending granted by Totalkredit and Nykredit Realkredit to be funded by covered bonds issued only out of Nykredit Realkredit. The Nykredit Group refers to this model as 'intra-group joint covered bonds funding' and is based on the legal framework of pooling assets as described in the answer to question 4 in section 2.1. The license was renewed in 2007 under the CRD III RMBS/CMBS framework although the model is not traditional securitisation.

The model ensures that all non-margin cash inflow from the portfolio of mortgage lending in Totalkredit is transferred directly to Nykredit Realkredit and from there to the holders of covered bonds.

The legal documentation securing the covered bond holders access to the collateral in Totalkredit is so-called 'master covered bonds' simply making sure, that the covered bond holders are secured by assets in a specific cover pool in Nykredit Realkredit + a specific cover pool in Totalkredit. Thus, the master covered bond in fact is a covered bond and NOT a MBS. Totalkredit also holds a license for covered bonds issuance.

To summarise why this is not traditional securitisation:
• All mortgage lending remains on balance of the originating

bank, i.e. both Totalkredit and Nykredit Realkredit;.

- This is a pure intra-group funding structure. Nykredit Realkredit does not include holdings of real (external) MBS in the covered bond cover pools. The credit quality of all (underlying) assets is currently verified under the group credit policy, e.g. the necessary information to fulfill the transparency requirements in CRR article 129 (7) is directly available to the Nykredit group;
- ALL assets securing the issued covered bonds are eligible for covered bonds collateral. This is not a re-packaging of non-eligible assets turning them into eligible collateral for covered bonds issuance;
- The setup is under supervision in line with the UCITS-requirements of supervision of covered bonds issuance.

Additionally, some business perspectives / reasons for having this intra-group structure covered bonds funding:

- It provides cheaper funding to the real economy;
- It allows all intra-group assets eligible as collateral for covered bonds to be used as collateral pooled in larger volumes and, thus, more liquid covered bonds issuance out of only one entity without bearing the costs of transferring the assets in between the intra-group entities.
- Small banks' customers get access to large scale covered bonds funding without changing their primary business relationship;

In the Nykredit group setup, it allows Danish local and regional banks to provide mortgage lending funded by covered bonds to their customers and at the same time keeping the full client service and management.

Finally, in the EBA Report on EU Covered Bond Frameworks and Capital Treatment (pub-lished 1 July 2014), the EBA considers it appropriate if article 496(1) is removed after 31 December 2017 (Recommendation EU COM 2 – C: Derogation on RMBS/CMBS in cover pools). However, the EBA notes the following (footnote 106):

"The EBA notes that in at least one Member State, intra-group transfers of collateral, i.e. covered bonds issued by an entity in the group and transferred into the cover pool of the covered bond program of another entity within the same group, have so far been based on Article 496 (1) a) and b) CRR. The assessment of the use of Article 496(1) CRR for such purposes is outside the scope of this report, but the EBA nonetheless recommends that the Commission should further consider whether a specific provision could be introduced in Article 129 CRR making it possible to allow specific intra-group transfers of CRR-compliant covered bonds as eligible collateral. From a prudential perspective, no additional risk appears to be introduced by such a provision, provided that the entity is sufficiently integrated into the group."

The funding model described in footnote 106 completely matches this Danish intra-group structured covered bonds funding model ('intra-group joint covered bonds funding') and we fully agree with the EBA conclusions concerning recommendation EU COM 2 – including footnote 106.

Please explain your answer to question 6:

4.1.2 Public sector loans

1. What are your views on the proposals for public sector loans as cover assets set out in subsection 4.1 of Part III?

2. What eligibility requirements in terms of validity and enforceability should apply to the guarantee granted by the relevant public sector entity?

When considering the development of a European framework for covered bonds, it might be worthwhile to bear in mind the significant importance of this issue to fundamental social obligations of the Members States, namely to provide housing. On the positive side of this link, developing a European framework should be able to promote growth and job creation in Member States with a less developed covered bond framework.

On the other hand, it should be mentioned that covered bonds in well developed covered bond jurisdictions are of paramount importance for providing funding for housing (and for financial stability in some jurisdictions). Changes to pillars of the housing finance provisions in Members States should be handled with particular caution given the social impact on their societies.

In Denmark, the loans to subisidised housing are not separated into a specific cover pool. These loans are typically guaranteed by public authorities where the LTV exceeds 60 %. The guarantee is a primary obligation for the guarantor to pay if the borrower defaults (i.e. the mortgage bank does not have to wait to see the loss through foreclosure). The gov-ernment also contributes to the mortgage payments and the most detailed regulation also enhances this segment to be a very secure asset class. But there is still a registered mortgage securing the underlying loan

4.1.3 Other assets: Aircraft, Ship and SME loans

1. Should the Framework exclude aircraft, ship and SME loans from cover pools or should they be allowed only subject to strict criteria and limits?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answers to question 1:

It is essential that loans in the cover pool are backed by collateral.

Regarding ship finance, no specific reason is given for introducing changes in this area. Ship mortgages were included in the covered bond definition set out in the first version of the CRD (Capital Requirements Directive) in 2006 and have been maintained in the subsequent revisions. Today, ships are included in Article 129 (1)(g) of the CRR (Capital Requirements Regulation).

Also, in relation to UCITS (Undertakings for Collective Investment in Transferable Securities), non-subordinated bonds for example issued by Danish Ship Finance (Danmarks Skibskredit A/S) are included on the Commission's lists of bonds that satisfy the criteria of Article 52 (4). They have been notified to the Commission as having a 10% risk weighting.

Thus, there is a long tradition of including ship mortgages on equal terms with mortgages over real estate in both national and EU legislation. Under national legislation, issuance of bonds by ship finance institutions is to a large extent subject to the same principles as issuance of mortgage bonds.

2. In relation to SME loans, is it possible to identify a category of "prime" SME loans as a potential eligible asset class for cover pools?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 2:

In Denmark, loans to SMEs can be funded through covered bonds insofar the loan is secured by a mortgage on real property and complies with the legal LTV limits for the given property category. Thus, SME-loans backed by mortgages on real property are a fully eligible asset class for cover pools.

In general, loans to agriculture, office and business, and private rental properties, in Denmark, are to a wide extent funded in the covered bond market (DATA on the share of mortgage funding to total funding of these segments?). A significant part of this lending would qualify as SME lending in conformity with the SME definition set out in the COM recommendation 2003/361/EF of 6 May 2003. (Note: two thresholds apply: (1) The annual turnover of a SME must not exceed EUR 50m, and (2) the credit institution's total exposure to the SME, excluding the part that is secured by a mortgage on residential property, must not exceed EUR 1.5m. According to the Danish Agriculture and Food Council no Danish agriculture has an annual turnover that exceeds EUR 50m.)

Pursuant to CRR Article 501, financial institutions can get a 'discount' on the capital requirement for SME exposures (by applying a reduced capital weight of 0.7619 on SME exposures defined in accordance with the COM recommendation).

We would like to highlight that covered bonds are financing SMEs in a significant proportion. However, it has to be noted that mortgage lenders/covered bond issuers do fund SMEs based on the quality of their mortgageable assets and not based on the fact that they are SMEs. If data on this is required, it can be provided on request.

4.1.4 Mixed pools and limits on exposures

1. Do you agree that mixed-asset cover pools should be allowed?

- (x) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

Please explain your answer to question 1:

The same cover pool may include all types of real estate without any restrictions on its composition. Any differences in the security of different types of real estate are reflected in different statutory LTV limits, valuation requirements and OC/capital requirements.

Cover pools consisting of loans secured on different types of real estate ensure a diversified cover pool risk.

In Danish mortgage banks, the mix is determined exclusively by borrower demand. For example, it is not possible to replace residential loans by commercial loans or vice versa as is the case in other member states. Investors see this as a sufficient guarantee of a predictable and even development in the cover pool mix. In a Danish context, it is, thus, irrelevant to restrict mixed asset cover pools. If mixed cover pools are not allowed, it will become more difficult to obtain sufficiently large bond series (i.e. LCR compliant issue sizes).

2.1 What are your views on the proposed limits on specific assets and concentration of exposures?

2.2 Should any other limits or requirements apply?

- ( ) Yes
- (x) No
- ( ) Don’t know / no opinion / not relevant

Please explain your answers to question 2:

4.2 Coverage requirement and overcollateralisation (see document)

4.2.1 Coverage requirement

1. Which option should be preferred for the Framework to formulate the coverage requirement?

- a general requirement along the lines of Article 52(4) of the UCITS Directive, amended to include the wording suggested by the EBA
- a nominal coverage
- [x] a net-present value coverage
- a net-present value coverage under stress
- any other or a combination of the some or all of the above
- Don't know / no opinion / not relevant

Please explain your answer(s) to question 1:

The Consultation Document considers proposals to set minimum over collateralisation re-quirements and minimum liquidity buffer requirements.

A specialised credit institution funds over-collateralisation and liquidity buffers by capital or other debt ranking junior to the covered bonds issued.

Regulations on capital and liquidity set forth in the Capital Requirement Regulation therefore impose minimum requirements on over collateralisation and liquidity buffers already and explicit cover pool specific minimum requirements on over collateralisation and liquidity buffers for specialised credit institutions would entail the risk of duplication.

2. If the coverage requirement were formulated as net-present value coverage under stress, should the stress tests be specified in any form in the Framework or ESMA/EBA regulatory guidelines?

- Yes
- [x] No
- Don't know / no opinion / not relevant

Please explain your answer to question 2:

3. Should derivatives entered into in relation to the cover pool be taken into account for the purpose of determining the coverage requirement?

- (x) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

3.1 If derivatives entered into in relation to the cover pool should be taken into account for the purpose of determining the coverage requirement, what valuation metric should be used for these purposes?

> Derivatives used for hedging purposes must be accounted for in the coverage requirement as their value ensures the balance between the value of cover assets and issued covered bonds.

4. What exposures to credit institutions within the pool should be taken into account to determine the coverage requirement and why?

> Exposures to credit institutions are an important asset class (typically used as a substitution asset or in the process of registration of the mortgage in the land register).
>
> Mortgage banks proceeds from covered bond issues are primarily placed in mortgage loans with real estate backing the loans. Over-collateral with the purpose of adding security to the covered bond investors is, in general, placed in eligible securities, such as government bonds and covered bonds.
>
> Under certain conditions and limits, it is also relevant to have exposures to credit institutions as cover in the cover pool, including exposures as counterparty on derivatives.
>
> Exposures to credit institutions (eligible for treatment under point 1c of Article 129 of the CRR) e.g. guarantees, should be acknowledged in combination with mortgage loans This may arise when the credit institution provides a temporary guarantee for pending the legal registration of the mortgage or the credit institution guarantees for mortgage payments on specific loans (loan loss guarantees).

4.2.2 Overcollateralisation

1. Should a quantitative mandatory minimum OC level be set in the Framework?

- ( ) Yes
- (x) No
- ( ) Don't know / no opinion / not relevant

Please explain your answer to question 1:

The balance sheet structure of universal credit institutions and specialised credit institutions differ.

The balance sheet of a universal credit institution reflects the diversification of business activities. Assets may include unsecured loans, loans secured by mortgages, loans otherwise secured, and securities holdings whereas liabilities may include deposits, unsecured debt, covered bonds, other secured debt, and equity.

Cover pool assets may include only a subset of assets eligible as collateral for covered bond issuance. The issuer is therefore in a position to replace assets inside the cover pool with assets outside the cover pool marked by the arrow (a) in the below chart or to add additional assets to the cover pool to enhance over collateralisation in support of the covered bond issued. However, this may give rise to asset encumbrance concerns.

The balance sheet of a specialised credit institution is less diversified but more transparent. Using Denmark as a benchmark assets of the specialised credit institution include loans secured by a mortgage and securities holdings whereas liabilities include covered bonds, other debt, and equity only.

The balance sheet structures are outlined in the below chart (Graph III/4.2.2/1 in attachment):

In some jurisdictions, e.g. France and Denmark, the bankruptcy privilege of covered bond investors includes all assets on the balance sheet of the specialised credit institutions. Consequently, securities holdings, whether funded by debt ranking junior to covered bonds issued or equity form part of the cover pool and are recognised as over collateralisation in support of the covered bonds issued.

As credit institutions, specialised institutions must comply with the capital and liquidity coverage requirements of the Capital Requirement Regulation. This implies that minimum over collateralisation levels are defined by minimum capital requirements. Therefore - in the context of a specialised institution - cover pool specific minimum requirements on over collateralisation and liquidity would duplicate requirements already in place.

In general, a minimum OC requirement that is calculated as a percentage of issued covered bonds or the loan portfolio is too simple as it doesn’t take account of the actual risk in the loan portfolio (not risk based approach). It would require the same OC level no matter if the loan portfolio consists of loans with 40 or 80 percent LTV.

2. If a mandatory minimum OC level were set in the Framework, should there be exceptions to the requirement (for example where the issuer applies a precise "match funding model" or where certain targeted liquidity and market risk mitigation measures are used – see subsection 4.3 of Part III)?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answer to question 2:

If a mandatory minimum OC level is considered for specialized credit institutions, it should be a risk based approach based on capital requirements as this represent what is needed to cover for losses in stress scenarios. Any stricter approach than this would undermine the purpose/meaning of the capital requirement as being sufficient to cover unexpected losses in various stress scenarios. Also in general, institutions applying a precise "match funding model" or equivalent model mitigating liquidity and market risk should also be excepted from a mandatory minimum OC requirement meant to mitigate such risks.

3. Should the Framework set a maximum level of permitted OC?

- Yes
- No (selected)
- Don't know / no opinion / not relevant

Please explain your answer to question 3:

Such a limit would not be relevant for specialised credit institutions. Any regulation seeking to protect unsecured investors against over encumbrance would be misplaced when no such creditors exist, and since all assets are fully encumbered anyway.

Also a legal maximum OC would impede growth by making covered bonds less attractive to investors.

4. Should the Framework provide for the treatment of voluntary OC in the event of insolvency/resolution of the issuer?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your answer to question 4:

Voluntary OC is vital to obtain a sufficient rating of the covered bonds. The creditors in the Danish mortgage banks are (nearly only) bondholders and the reservation of OC does not (potential) conflict with the interests of deposits.

4.3 Cover assets/liabilities risk mitigation: market and liquidity risks (see document)

1. In your view, are OC levels adequate to mitigate market and liquidity risks in the absence of targeted measures such as those described in subsection 4.3 of Part III?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Please explain your answer to question 1:

High OC levels can reflect asset-liability mismatches, i.e. market and liquidity risks. However, other tools or measures may address the same risks. A requirement of a minimum OC level may punish systems, to that eliminate or minimise asset-liability mismatch risks.

The pass through structure of covered bonds issued by Danish specialised mortgage banks virtually eliminates asset-liability mismatches. The Danish Mortgage-Credit Loans and Mortgage-Credit Bonds etc. Act and the Executive Order on bond issuance, balance principle and risk management require the mortgage banks to observe a specific balance principle and a set of risk management rules in connection with the issuance of covered bonds.

Please refer to Addendum III/4.3/1

2.1 Should the Framework lay down specific requirements on the use of derivatives as suggested in subsection 4.3 of Part III?

- ○ Yes
- ● No
- ○ Don't know / no opinion / not relevant

2.2 How should "eligible counterparties" be defined for the purposes of entering into permitted derivatives?

An eligible counterparty is a derivative counterparty that is a credit institution (or otherwise regulated financial institution as an insurance company). In case there has to be any restrictions on eligible credit institutions, it should take proper account of credit enhancing collateral/margin requirements in the derivative contracts. The derivative should address imbalances between the funding and the loans and should, in this situation, have the same legal status as covered bonds.

Please explain your answers to question 2:

2.1 Should the Framework lay down specific requirements on the use of derivatives as suggested in subsection 4.3 of Part III PDF?
No. Intra-group derivatives should be allowed as a useful tool to mitigate imbalances between covered bonds and loans. Any potential downgrade or similar changes to the counterparty or the exposure can be off-set by using collateral (either up front or through margin payments to level the credit risk).

3. What are your views on the potential provisions on the management of cashflow mismatches suggested in subsection 4.3 of Part III ?

In particular:

3.1 **For issuers**, do cashflow mismatches between cover assets and covered bonds arise in your jurisdiction and/or transactions?

- Yes
- No
- Don’t know / no opinion / not relevant

3.1.1 Are you able to describe a scenario for the timely repayment of the covered bonds?

3.1.2 Do you plan for contingencies?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 3.1.2:

3.1.3 Are such scenarios and contingencies disclosed to investors?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 3.1.3:

3.2 **For investors**, do you understand how such cashflow mismatches would be dealt with in practice?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 3.2:

As described in the answer to question 1, cash flow mismatches are very limited in the Danish specialised mortgage banking business model simply to the fact that interest rate, currency and option features of the cover assets match the features of the issued covered bonds and also due to daily tap issuance. Liquidity and refinancing risk is addressed by the pass-through structure (e.g. installment payments or prepayments from borrowers are passed through as drawings to the bond holders) and statutory maturity extension in predefined circumstances. The latter is combined with the ban of acceleration of covered bonds payments upon insolvency or resolution of the issuer.

Consequently, this means that cash flow mismatches primarily arise from credit risk (i.e. arrears on mortgage lending) in the Danish specialised mortgage banking business model. According to The Danish Mortgage-Credit Loans and Mortgage-Credit Bonds etc. Act, the capital requirements related to the mortgage lending must be included in the cover pool, i.e. this is a statutory OC requirement of minimum 8% of the risk exposure amount. Since Danish specialised mortgage banks are non-deposit taking banks and -by law- are only allowed to fund mortgage lending by covered bonds issuance, all statutory OC as well as additional voluntary OC is placed in liquid securities (typically High Quality Liquid Assets in accordance with the LCR Delegated Act) or deposits with central banks or credit institutions. To sumup all features and placement rules; this means that plenty of liquidity is present to cover for contingencies.

The Danish specialised mortgage banking business model - including statutory requirements and placement of OC - are described in the base prospectuses for the issuance of covered bonds and, thus, disclosed to the investors.

3.2.1 Would it be beneficial from your perspective to get systematic information about cashflow mismatches and how these would be managed?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 3.2.1:

4.1 On the EBA's liquidity buffer recommendation, should covered bond issuers hold a "liquidity buffer" to mitigate liquidity risk in the cover pool?

- Yes
- No
- Don't know / no opinion / not relevant

4.2 Should the buffer be calibrated to cover the cumulative net out-flows of the covered bond programme over a certain time frame?

- Yes
- No
- Don't know / no opinion / not relevant

4.3 What eligibility criteria should liquid/substitution assets meet to qualify for the purposes of this buffer?

As described previously, the specialised mortgage banking business model is by law required to hold a liquidity buffer to mitigate liquidity risk in the cover pool.

We find the LCR sufficient for the liquidity buffer. Features mitigating liquidity or refinancing risk should already be taken into account in the LCR and NSFR regulation. Hence, no further or specific liquidity buffer requirements should apply to covered bonds issuance.

5. Transparency requirements (see document)

1.1 What are your views on the current disclosure requirements set out in Article 129(7) of the CRR?

The disclosure commanded by article 129(7) or the CRR is sufficient for the investor to assess the credit quality of the covered bond both in absolute terms and in relative terms to other covered bonds.

The disclosure should be seen in conjunction with the prospectus and additional disclosure in market driven formats such as the covered bond label. We believe the combination of article 129(7) of the CRR and the covered bond label to provide investors with a more than adequate basis for assessing the credit quality of a covered bond both in absolute terms and relative to other covered bonds. The combination of regulatory minimum standards and a market driven initiative susceptible to the development in market demand is highly valuable.

1.2 If more detailed requirements were preferred, do you agree that issuers should disclose data on the credit, market and liquidity risk characteristics to a more granular level?

- ○ Yes
- ◉ No
- ○ Don't know / no opinion / not relevant

Please explain your answer to question 1.2:

A high level of transparency has always been an important characteristic of the Danish covered bond market.
Danish issuers have an ongoing dialog with investors about the disclosure of information, and adjustments are made to the disclosure set-up on that basis. We believe that such a process gives a better result for the investors than of a set of more detailed requirements in the CRR.

2. Should issuers disclose information on the counterparties involved in a covered bond programme?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

3. How frequently should covered bond issuers be required to make disclosures to investors?

We support disclosure on quarterly basis at cover pool level.

4. What are your views on the existing and prospective investor reporting templates prepared by industry bodies and referred to in section 5 of Part III?

The ECBC label initiative based on national transparency templates (NTT) has encouraged Danish covered bond issuers to harmonise and deepen the cover pool reporting, which has increased transparency in the Danish covered bond market. All Danish issuers of covered bonds have joined the ECBC label. Much emphasis has been put on ensuring uniform definitions and calculation methods, and the NTT has been updated and further developed on an ongoing basis since the introduction. Among other things, explicit reference to the CRR 129(7) disclosure requirements has been incorporated. The NTT is perceived to be a good transparency tool for investors with advance knowledge of the Danish market.

4.1 Would these templates be granular enough to enable investors to carry out a comprehensive risk analysis as recommended by the EBA?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 4.1 :

We believe the combination of article 129(7) of the CRR and the covered bond label to provide investors with a more than adequate basis for assessing the credit quality of a covered bond both in absolute terms and relative to other covered bonds. Covered bond investors may further demand background information such as macroeconomic indicators and descriptions of certain legal aspects of covered bond systems before making decision on investments however such information is difficult to standardize and contain in disclosure templates.

4.2 Would these templates be sufficient without further legislative backing to deliver enhanced and consistent disclosure in European covered bond markets?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 4.2 :

The combination of regulatory minimum standards and a market driven initiative susceptible to the development in market demand is highly valuable.

5. Should detailed disclosure requirements apply to:

- (selected) all European covered bonds
- or only to those that would fall within the scope of the Prospectus regime
- Don’t know / no opinion / not relevant

Please explain your answer to question 5:

Generally, detailed disclosure requirements should apply to all European covered bonds, as the markets differ when it comes to the scope of private placements of covered bonds. Especially if a capital centre/cover pool could contain both types, the disclosure requirements should apply to all bonds in the pool.

The cover pool disclosure requirements contained in the investor reporting templates dis-cussed above are of a much more detailed nature, and the information is updated more frequently, compared to the information contained by the prospectus which mainly includes or refers to accounting information on a company level.

Prospectuses in Denmark

In Denmark, all covered bonds are optionally listed on a stock exchange and issued under a base prospectus. The base prospectus can be valid as long as bonds are issued on an ongoing basis (more than 1 year), due to the Prospectus Directive Normal financial information is generally not perceived as being price-sensitive for covered bonds, thus the publication of interim financial reports will not in its own demand the publication of an addendum to the base prospectus, save for the annual accounts and extraordinary Financial information which change the financial position of the Issuer Any legislative and/or rating related changes significant to the risk profile of the covered bonds will demand a publication of an addendum. There is a specific guidance from the Danish FSA, available on their website on when it is necessary for Danish mortgage banks to publish addendums.

As the covered bonds are publicly listed, trade data must be reported to the stock exchange immediately after the trade, and detailed bond data is available on the stock exchange’s website. This ensures a high degree of transparency also when it comes to the pricing of covered bonds.

6. Should the same level of disclosure standards apply pre- and post-insolvency/resolution of the issuer (except for those reporting items referring to the issuer itself)?

- Yes
- No
- Don’t know / no opinion / not relevant

Please explain your answer to question 6:

```
In our view, it will depend of the legal status of the cover pool. If
the cover pool is totally segregated from the insolvency
estate/resolution, e.g. with some form of license, it will be
appropriate with the same level of disclosure standards.

But, if the cover pool only will be handled as a insolvency cover pool,
it will be a burden for the administrator and therefore a unnecessary
cost for the bond holder
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7. In relation to covered bonds issued in third countries, what minimum level of disclosure should apply for European credit institutions investing in those instruments to benefit from preferential risk weights?

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To get the benefit from preferential risk weights you need to have the
same minimum level of disclosure for covered bonds issued in third
countries to secure level playing field.
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3. Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) here:

- **23473a2a-2332-44cd-bea0-920861041b13/CB CP Reply Final Approved Modified.pdf**
- **312245a9-f575-4120-9b5b-a91360869098/Common reply - Addendum to the webtemplate.pdf**
- **0b33ebf4-1cfe-43c7-90cd-377fca91b5ff/Letter to Commissioner Hill from RKR, RKF, FR on covered bonds.pdf**

Useful links

Consultation details (http://ec.europa.eu/finance/consultations/2015/covered-bonds/index_en.htm)

Consultation document (http://ec.europa.eu/finance/consultations/2015/covered-bonds/docs/consultation-document_en.pdf)

Economic analysis (http://ec.europa.eu/finance/consultations/2015/covered-bonds/docs/consultation-document-annex_en.pdf)

Specific privacy statement (http://ec.europa.eu/finance/consultations/2015/covered-bonds/docs/privacy-statement_en.pdf)

More on the Transparency register (http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

Contact

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